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In The
SUPREME COURT OF THE UNITED STATES

No. 71-696

OCTOBER TERM, 1971

IN THE MATTER OF
CHARLEY PAUL McLAIN, *Bankrupt,*

UTICA SQUARE NATIONAL BANK OF TULSA, *Creditor*
Petitioner

vs.

FRED W. WOODSON, *Trustee,*
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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vs.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

TO THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your Petitioner, Utica Square National Bank of Tulsa, a national banking association (now Utica National Bank & Trust Company, a national banking association, hereinafter referred to as "Bank"), hereby petitions for a Writ

of Certiorari to review the Decision of the United States Court of Appeals for the Tenth Circuit. That Court of Appeals, on direct appeal, reversed and remanded for further proceedings consistent with its opinion, thereby reversing the Order of the United States District Court for the Northern District of Oklahoma, which Order affirmed and adopted the Order of the Referee in Bankruptcy making findings of fact and conclusions of law, sustaining the Bank's secured creditor's claim, and overruling the Trustee's objection thereto.

OPINIONS BELOW

The opinion of the Court of Appeals was filed August 27, 1971, is reported at ..... F.2d ....., and a copy thereof is appended hereto as Appendix A.

The Order of the Referee in Bankruptcy making findings of fact and conclusions of law, sustaining the Bank's secured creditor's claim, and overruling the Trustee's objection thereto, is dated and filed August 27, 1970, is unreported, and a copy thereof is appended hereto as Appendix B.

The Order of the United States District Court for the Northern District of Oklahoma, affirming and adopting the findings of fact and conclusions of law of the Referee in Bankruptcy, is dated September 30, 1970, filed October 1, 1970, is unreported, and a copy thereof is appended hereto as Appendix C.

JURISDICTION

The judgment of the Court of Appeals which Petitioner seeks to have reviewed was made and entered on August

27, 1971. An order denying a timely petition for rehearing was made and entered by said Court of Appeals on October 4, 1971. The statutory provision believed to confer jurisdiction on this Court to review the judgment in question is 28 U.S.C. Sec. 1254 (1).

QUESTION PRESENTED FOR REVIEW

Is a debtor's written warranty, covenant and agreement, as to his intended future use of collateral goods, *conclusive* proof of such intended future use, when (1) the written warranty, covenant and agreement is contained in a security agreement executed by the debtor in connection with a purchase money loan to finance purchase of the goods, (2) the debtor's intended future use of the goods as of the time of purchase determines their classification and the proper county for filing under the Uniform Commercial Code, (3) the debtor is subsequently adjudicated a bankrupt, and (4) the Trustee in Bankruptcy claims and seeks to prove that the bankrupt's intent at the time of purchase was not as stated by his written warranty, covenant and agreement, therefore the filing occurred in the wrong county, and the security interest was unperfected and voidable as a preferential transfer.

CONSTITUTIONAL PROVISIONS, STATUTES, AND REGULATIONS INVOLVED

involved are Title 11, United States Code, Secs. 96(a) (1), (a) (2), (a) (7), and (b), 110(a) and (c); Title 12A, Oklahoma Statutes Annotated, Secs. 9-109, 9-301 (2) and (3).

9-303(2), 9-312(4), 9-401(1) and (3), and 9-405(1). Since these provisions are lengthy, they are reproduced in Appendix D hereto.

STATEMENT OF THE CASE

The pertinent facts in this case are undisputed. The Bank is a creditor of the estate of the bankrupt, Charley Paul McClain. It seeks to claim as a secured creditor, and receive the fruits of its collateral, namely, one 1969 Chevrolet Fleetside Pickup Truck. The Trustee concedes the Bank's status as general unsecured creditor, but objects to the allowance of a secured claim.

The Bank's claim is supported by a negotiable promissory note, given by the bankrupt to the selling dealer in payment of the purchase price of the truck, and by a financing statement and security agreement by which the bankrupt, pursuant to the Oklahoma Uniform Commercial Code, 12A O.S.A. Sec. 1-101 et seq, gave a security interest in the truck to secure payment of the promissory note. One of the provisions in the security agreement permits the debtor to give his warranty, covenant and agreement as to whether the collateral "is to be used primarily (check 1, 2 or 3) (1) In business, (2) For personal, family or household purposes, (3) In farming operations." In this case, the "In business" use designation was checked.

On the same date the promissory note, financing statement and security agreement were given, the selling dealer, without having first attempted to perfect its security

interest by a proper notice filing, negotiated the promissory note to the Bank, which took as a holder in due course for value and without notice of any defects. The Bank, in good faith, and relying exclusively on the "In business" use designation in the security agreement, determined thereby that the collateral was equipment, as defined in 12A O.S.A. Sec. 9-109; and that its security interest would be duly perfected by central notice filing in Oklahoma County as provided by 12A O.S.A. Sec. 9-401(1). Thereafter, and within the ten day grace period permitted for perfecting purchase money security interests in non-inventory goods, as provided by 12A O.S.A. Secs. 9-301(2), 9-312(4), and 9-405(1), the Bank filed the financing statement and security agreement centrally in Oklahoma County.

The Trustee's objection to allowing the Bank a secured claim proceeds upon the theory that at the time the bankrupt purchased the truck, he in fact did not intend to use it primarily for business purposes; that instead, the bankrupt's intent was to use the collateral primarily for personal purposes, and therefore it was consumer goods under 12A O.S.A. Sec. 9-109, not equipment; and that the proper place for notice filing on consumer goods is the county of the debtor's residence, which in this case was alleged to be Tulsa County. If this were true, then the security interest was unperfected at the time the petition in bankruptcy was filed, and would therefore be voidable as a preferential transfer under 11 U.S.C. Secs. 96(a) (1), (a) (2), (a) (7), and (b).

As evidence of the bankrupt's intent, the Trustee, at the hearing on the objection to allowance of the Bank's claim, offered the bankrupt's testimony tending to show that after purchasing the pickup, he in fact used it for certain personal and family purposes. The Bank objected to the admission of this evidence on the ground that the bankrupt's warranty, covenant and agreement in the security agreement as to intended future use was conclusive on the question of such intent, and that the proffered evidence was barred by the parol evidence rule. The Referee in Bankruptcy sustained the Bank's objection to the introduction of such evidence, and after making findings of fact and conclusions of law, sustained the Bank's claim as a secured claim and overruled the Trustee's objection.

The United States District Court for the Northern District of Oklahoma agreed with the decision of the Referee in Bankruptcy, and in due course entered an order affirming and adopting the Referee's findings of fact, conclusions of law, and decision.

The Court of Appeals reversed, holding that the testimony concerning actual use was admissible on the question of intent, remanded the case for further proceedings on the Trustee's objection. The reasoning of the Court of Appeals will be considered in detail in the Argument set forth below.

ARGUMENT

The decision of the Court of Appeals makes a shambles of the secured transactions provisions of the Uniform Commercial Code, as adopted in Oklahoma, the other states of the Union, (except Louisiana), and the District

of Columbia and the Virgin Islands. It does so needlessly, it is believed, being compelled by neither precedent, logical statutory interpretation, nor reasons of policy. Further, from the standpoint of administration of justice, it drastically increases the likelihood of objections to secured claims in bankruptcy and the necessity of evidentiary hearings to adjudicate such objections. Every claim secured by a purchase money pledge of chattels will now be subject to attack by the Trustee, based on a contention that the subjective intent of the bankrupt at the time of purchase, as to how he was going to use the goods *in the future*, was not really as expressed in his solemn, written warranty, covenant and agreement. The clogging of the bankruptcy courts which will result is incalculable, but some insight into the magniture of the problem can perhaps be gained by simply considering the central role played by installment debt in the great majority of personal bankruptcies currently being filed. This Court of Justice must prevent such an eventuality from coming to pass.

Consider the problem in the following terms: to induce lenders to advance moneys on the strength of security to be provided by goods purchased with such moneys, the drafters of the Uniform Commercial Code extended such lenders, called purchase money lenders, a special protection. Their security interests were made automatically perfected for the ten day period following receipt of the goods by the debtor, so as to allow for a reasonable opportunity to complete the mechanics of notice filing. See 12A O.S.A. Secs. 9-301(2) and 9-312(4). The place for filing is determined by the classification of goods, 12A

O.S.A. Sec. 9-401(1), and such classification, for the non-purchase money lender, is a matter of determining the primary use to which the goods have been put prior to the loan. See 12A O.S.A. Sec. 9-109, and Comment 2 thereto. However, in purchase money situations, there can be no meaningful use within the ten days when filing must occur, and therefore the Code determines classification in these cases based on how the goods are "bought for use", i.e., the debtor's intended future use at the time of purchase. 12A O.S.A. Sec. 9-109. Consistently, the Code further provides that if a filing is correctly made originally, such filing is not impaired by later changes in use. 12A O.S.A. Sec. 9-401(3).

Faced with determining such subjective intent, purchase money lenders did what any reasonable and sensible person might expect of one attempting to comply with the Code. They required a written warranty, covenant and agreement from the debtor concerning his subjective intent as to future use. But, says the Court of Appeals, such warranty, covenant and agreement is not conclusive. The Court frees the Trustee to attmpt to prove that the debtor misrepresented, lied, was confused, mistaken, etc. This, it is submitted, makes a farce and mockery of the system which the Code drafters attempted to devise. Only the debtor can know his intent at the time the goods are purchased. Surely the Code drafters did not envision that lenders could read minds. Yet this is precisely the duty imposed by the decision of the Court of Appeals.

Even so, if there were compelling precedent or pol-

icy reasons for such a result, perhaps the Bank could not complain. But such reasons do not exist. The Court of Appeals opinion is silent on the matter of policy, undoubtedly because all such considerations augur strongly in favor of strictly enforcing the debtor's warranty, covenant and agreement. Certainty in the law, sanctity of contracts, the minimization of opportunity for perjury, infirmity of memory, the unavailability, absence or death of witnesses, plus the very integrity of the filing system itself, all require that the debtor's warranty, covenant and agreement be conclusive. These are the selfsame considerations which underlie the concepts of parol evidence, best evidence, competency of evidence and the like, and, it is submitted, they apply with even more than usual force to the parol testimony of a bankrupt who has just undergone the stress of bankruptcy and is subject to its pressures and humiliation. The finality of the warranty, covenant and agreement, and the inadmissibility of evidence to vary it, seem further required by the Code provision that if the original filing based on intended future use was proper, a subsequent change of actual use will not impair the validity of that filing. 12A O.S.A. Sec. 9-401(3).

As for precedent, the Court of Appeals cites only *National Bank of Commerce v. First National Bank of Tulsa*, 446 P.2d 277 (Okl. 1968), *Sequoia Machinery, Inc. v. Jarrett*, 410 F.2d 1116 (9 Cir., 1969), and *P. S. Products Corp. v. Equilease Corporation*, 435 F.2d 781 (2 Cir., 1970). But while these cases involve classification of goods, they are but makeweights here, and should be recognized as such and discarded. In none of these cases was the written warranty, covenant and agreement of the debtor, as to in-

tended future use, put in issue. In none was the question of admissibility of evidence to vary a written warranty, covenant and agreement even raised. In none was the distinction between purchase money and non-purchase money security interests discussed. Indeed, it is not clear whether purchase money security interests were even involved. In sum, the application of these cases is, perhaps best gauged by the fact that the Trustee did not cite or rely on any of them in either his original or reply briefs in the Court of Appeals.

Admittedly, the Uniform Commercial Code does not expressly state that the debtor's written warranty, covenant and agreement shall be deemed conclusive. But common sense dictates that such was an unspoken assumption of the Code drafters. How else could their approach to notice filing on purchase money security interests be expected to work? This being the case, it would seem the legitimate function and duty of the courts to proceed constructively, to fill in the gaps in codification and apply a rule of evidence which makes the statutory system of notice filing workable. Instead, the Court of Appeals chose to destroy that system, to throw up its hands and, somewhat forlornly, advise purchase money lenders to "file in all possible counties where filing might be required." Opinion, p. 9.

What possible justification can be given for such a result? The Court of Appeals offered only one. It reasoned that the Trustee is both successor in interest to the property of the bankrupt under 11 U.S.C. Sec. 110(a), and ideal lien creditor under 11 U.S.C. Sec. 110(c). In

his latter status, the Trustee is a third party stranger to the original security agreement. The Court of Appeals relied upon the general law to the effect that the parol evidence rule may not be raised against such a third party to bar admission of evidence tending to vary the bankrupt's intent as expressed in the written warranty, covenant and agreement. Opinion, pp. 5-6. On this most hypertechnical of grounds was the issue decided against the Bank, and the District Court and Referee overruled.

The Bank denies and rejects that issues of such a momentous and pervasive character and broad application should be decided on formalistic distinctions of this kind, without consideration being given to the matters of policy, statutory construction and interpretation heretofore discussed. Further, even the rule relied upon by the Court of Appeals is subject to an exception which requires the rejection of parol evidence, even when offered by a third party stranger to the original agreement. This exception is based on the fact that the Bank, in addition to being a purchase money lender, was also a holder in due course. Parol evidence is not admissible on behalf of *any* party as against a holder in due course to explain or vary the terms of a negotiable instrument. *Clarke v. Clarke*, 194 Okl. 455, 152 P.2d 908, 910 (1944); see also *McLean v. Paddock*, 430 P.2d 392 (N.M., 1967), and 12 Am. Jur. 2d, *Bills and Notes*, Sec. 1295. By analogy, the exception applies to prohibit the introduction of parol evidence by any party to vary or explain the terms of real or chattel security agreements securing the repayment of a negotiable instrument in the hands of a holder in due course. See *First National Bank of Coyle v. Horsley*, 174

Okl. 83, 49 P.2d 495 (1935); *Klein v. Federal Life Ins. Co.*, 169 Okl. 632, 37 P.2d 937 (1935); *Wendling v. Aurelius-Swanson Co.*, 106 Okl. 63, 232 P. 932 (1925); *Foster v. Augustana College & Theological Seminary, of Rock Island, Ill.*, 92 Okl. 96, 218 P. 335 (1923); and *Farmers' National Bank of Tecumseh v. McCall*, 25 Okl. 600, 106 P. 866 (1910).

The Court of Appeals tried to distinguish these Oklahoma cases on the ground that the rights of third party strangers to the agreement were not there in question. Opinion, pp. 6-7. But such is clearly not the case. For example, *Horsley* involved the rights of a third party, a mechanic's lienor who claimed that he had priority over an assignee of a mortgage, the assignment having occurred after the mechanic's lien was filed. The Oklahoma court held the assignee-holder in due course entitled to priority, even as against a defense which the mechanic's lienor could successfully have urged against the original mortgagee.

The Court of Appeals also seemed to say that the exception assumes as a precondition to its application that the security interest be properly perfected, and that the exception could not operate to preclude parol testimony on the issue of perfection itself, i.e., on whether constructive notice of the security interest was given. Opinion, p. 7. *But the Court of Appeals absolutely overlooked and ignored the fact that the security interest here in issue was perfected during the ten day period following execution. It was automatically perfected against lien creditors, including the Trustee, without the necessity of notice filing,*

by virtue of 12A O.S.A. Secs. 9-301(2) and 9-312(4). If bankruptcy had occurred during this ten day period, there is no question but that the Bank's secured claim would be allowed. There is, therefore, no reason in logic, and the Court of Appeals gave none, why during this ten day period, the Bank, as holder in due course, should not be entitled to rely on *all* the provisions of the security agreement. There is no reason in logic, and the Court of Appeals gave none, why the Bank, as holder in due course, should not be protected by the parol evidence rule against efforts to vary *any* of the provisions of the security agreement which it relied upon during such ten day period. And as stated at the outset, it was during this ten day period that the Bank did rely on the security agreement, *exclusively*, in notice filing in Oklahoma County so as to continue the perfection of its security interest without interruption, beyond the initial ten day period, all as permitted by 12A O.S.A. Sec. 9-303(2).

It is thus clear that such grounds as were offered by the Court of Appeals for its decision cannot be supported. What is most distressing, however, is that it did not even weigh in the balance the policy considerations and practical effects of what it was doing.

CONCLUSION

The decision of the Court of Appeals, insofar as purchase money financing is concerned, constitutes an effective abandonment of Oklahoma's system of secured transactions. As stated at the outset, an objection and evidentiary hearing thereon will now become the rule instead

of the exception in most personal bankruptcies, particularly where motor vehicles, which frequently comprise the only asset of readily salable value, are involved. To avoid this result will require double, triple or even greater number of filings by purchase money lenders in an attempt to insure perfection, at tremendous increased costs in filing; clerical and related expenses. Such an eventuality need not, and should not, come to pass, and the Bank respectfully urges the Court to find accordingly.

This Court should grant certiorari, and the judgment of the Court of Appeals should be reversed with directions to reinstate the Judgment of the District Court.

Respectfully submitted.

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